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No. 81-523

In the Supreme Court of the United States

OCTOBER TERM, 1982

CONTAINER CORPORATION OF AMERICA,
Appellant,

v.

FRANCHISE TAX BOARD,
Appellee.

On Appeal From the Court of Appeals
of the State of California

BRIEF OF THE STATE OF OREGON AS AMICUS CURIAE IN SUPPORT OF BRIEF OF FRANCHISE TAX BOARD

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STATEMENT OF INTEREST OF STATE OF OREGON AS AMICUS CURIAE

The State of Oregon, through its former State Tax Commission and present Department of Revenue has, since approximately 1955, applied the principles of formulary apportionment of the income of a corporation conducting a single unitary business. The state has applied principles of combined reporting and formulary apportionment of the income of a parent corporation and its subsidiaries likewise conducting a unitary multistate or multinational business. The state has established offices in New York, Chicago, San Francisco and Los Angeles to aid in the auditing of multistate and multinational corporations. In 1965

the state adopted the Uniform Division of Income for Tax Purposes Act (ORS 314.605 to 314.670). In 1967, it enacted the Multistate Tax Compact (ORS 305.655 to 305.685). Application of the unitary business principle and formulary apportionment has been upheld by the Oregon Supreme Court.[1]

Thus, the State of Oregon has an immediate and direct interest in this case as well as *Chicago Bridge & Iron v. Caterpillar Tractor Co.*, 84 Ill.2d 102, 417 N.E.2d 1343 (1981); oral argument in this Court April 19, 1982; reargument ordered by this Court May 3, 1982. (81-349). Oregon's raising and expenditure of revenue will be affected by the determination of the issues raised in this case and in *Chicago Bridge,* with regard to the constitutionality of nondomiciliary state taxation of worldwide combination.

In addition, after this case was decided by the lower court, the previously accepted methods of determining what constitutes a unitary operation for purposes of combined reporting have been put into question by the recent decisions of this Court in *ASARCO, Inc. v. Idaho State Tax Commission,* — U.S. —, 102 S. Ct. 3103, 73 L. Ed.2d 787, 50 U.S.L.W. 4962 (1982); and *F. W. Woolworth Co. v. Taxation & Revenue Dept.,* — U.S. —, 102 S. Ct. 3128, 73 L. Ed.2d 819, 50 U.S.L.W. 4957

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[1] *Coca-Cola Co. v. Dept. of Rev.*, 271 Or. 517, 533 P.2d 788 (1974); *Zale-Salem, Inc. v. Tax Comm.*, 237 Or. 261, 391 P.2d 601 (1964). *See,* also *Caterpillar Tractor Co. v. Dept. of Rev.*, 289 Or. 885, 618 P.2d 1261 (1980); *Donald M. Drake Co. v. Dept. of Rev.*, 263 Or. 26, 500 P.2d 1041 (1972).

(1982). These cases are being relied upon by Appellant Container Corp. [hereinafter "Container"] in this case. Oregon has a vital interest in the applicability and correctness of the standards announced in these cases.[2]

SUMMARY OF ARGUMENT

At stake in this case is a state's authority to use the only reasonable and economically feasible method for determining the portion of a corporation's net income that is attributable to the activities of the corporation in the state, where the corporation is a part of an affiliated group engaged in a unitary business. Oregon supports the following propositions:

1. Combination and apportionment on worldwide basis is constitutional and does not violate either the Commerce Clause or the Due Process Clause. There is no extraterritorial taxation or multiple taxation of foreign source income through the use of combined reporting. Until Congress acts to prohibit the states from utilizing the unitary principle and each foreign country acts with respect to political subdivisions or entities within its territories, there can be no violation of the Commerce Clause.

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[2]Thus, even if this Court should grant Idaho's and New Mexico's petition for rehearing and redetermine the due process standard for including dividends and other intangible income of a subsidiary in the apportionable income tax base of a parent to accord with the "business purpose" test advanced by the states, the *ASARCO* and *Woolworth* decisions need re-examination in light of the Court's basic determination of what constitutes the test of a unitary business for purposes of combined reporting and formulary apportionment.

2. The *ASARCO* and *Woolworth* decisions, if correctly understood, indicate unrealistic and unreasonable due process standards for the utilization by the states of the unitary business principle in combining and apportioning the net income of affiliated corporations. If applied to this case, clarification of the Court's language is needed.

3. The facts in this case support the conclusion that Container is unitary with its foreign subsidiaries, unless a prohibitive standard is erected on the basis of this Court's recent decisions in *ASARCO* and *Woolworth*.

ARGUMENT

I

WORLDWIDE FORMULARY APPORTIONMENT DOES NOT VIOLATE THE DUE PROCESS CLAUSE AND DOES NOT PRODUCE EXTRATERRITORIAL TAXATION. THERE IS NO VIOLATION OF THE COMMERCE CLAUSE BECAUSE NO MULTIPLE TAXATION OF FOREIGN SOURCE INCOME CAN BE PROVEN. THERE ARE NO ENFORCEABLE UNIFORM STANDARDS WITH RESPECT TO THE STATES AND THIS COUNTRY AND WITH RESPECT TO THE INTERNATIONAL SCENE. BEFORE AN ARGUMENT CAN BE MADE THAT THE FEDERAL GOVERNMENT IS PREVENTED FROM SPEAKING WITH ONE VOICE IN REGARD TO FOREIGN POLICY, CONGRESS MUST ACT.

A. There is no extraterritorial taxation. Container cannot pick out certain factors based upon separate accounting principles as showing extraterritorial taxation.

In considering whether there can be any extraterritorial taxation of income earned in foreign countries, Container uses separate accounting to support its arguments that the foreign subsidiaries operated at a substantially higher rate of profitability than Container. The arguments are that there are lower wage rates in foreign operations and that Container's net income as a percentage of sales or a percentage of invested capital is less than that attributable to foreign operations. Container's arguments have no validity whatsoever if, in fact, Container and its foreign subsidiaries are operating a unitary business. As stated by this Court in *Butler Bros. v. McColgan,* 315 U.S. 501, 62 S. Ct. 701 (1942), *aff'g.* 17 Cal.2d 664, 111 P.2d 334, at page 507:

> "It is true that appellant's separate accounting system for its San Francisco branch attributed no net income to California. But we need not impeach the integrity of that accounting system to say that it does not prove appellant's assertion that extraterritorial values are being taxed. Accounting practices for income statements may vary considerably according to the problem at hand. Sanders, Hatfield & Moore, A Statement of Accounting Principles (1938), p. 26. A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a

> State seeks to tax values created by a business within its borders. * * *"

If this Court finds that Container and its foreign subsidiaries are truly operating a unitary business, neither this Court nor California need attack the integrity of Container's accounting evidence.

When a group of affiliated corporations is truly operating a unitary business, the several states face "the impossibility of allocating specifically the profits earned by the processes conducted within its borders." *Butler Bros. v. McColgan, supra* at page 507, quoting Mr. Justice Brandeis in *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113, 121 (1920). In *Coca-Cola Co. v. Dept. of Rev.,* 271 Or. 517, 533 P.2d 788 (1974), the Oregon Supreme Court quoted from the California Supreme Court decision, affirmed by this Court in *Butler Bros. v. McColgan, supra,* to the effect that:

> "'* * * It is only if its business within this state is truely separate and distinct from its business without this state, so that the segregation of income may be made clearly and accurately, that the separate accounting method may properly be used. Where, however, interstate operations are carried on and that portion of the corporation's business done within the state cannot be clearly segregated from that done outside the state, the unit rule of assessment is employed as a device for allocating to the state for taxation its fair share of the taxable values of the taxpayer [citing authorities].' 17 Cal.2d 667-678." 271 Or. at 523, 533 P.2d at 791.

Thus, if this Court determines that Container and its foreign subsidiaries are a truly unitary business, it

may disregard any evidence as to differences in profitability or wage rates.

One may appropriately ask why it is that a United States company would expect to receive a greater rate of return on a foreign investment than on a similar domestic investment. (App. Br. 14) Container does not say that it is exclusively due to lower labor costs. Container states at page 14 of its brief that "the reasons for this *include* lower labor costs, more rapidly expanding economies, greater market share, governmental protection from compliance, *etc.*" Therein lies the rub. It was recognized early in the development of the theory of apportionment formulas that:

> "* * * Business income is generally attributable to a great number of factors or activities, the relative importance of which may vary greatly in different businesses. Any attempt to determine precisely the factors and activities responsible for the earning of income and their relative weight, even in the case of a single business, is certain to encounter serious difficulties. To make such a determination in the case of all taxpayers subject to any particular state's taxing law is utterly out of the question as a practical administrative matter. Thus, in this field, as in many other fields, the ideal cannot be obtained. Something less than perfection must suffice." Altman & Keesling, *Allocation of Income and State Taxation* 107-108 (2d. ed 1950).

For these reasons, this Court has said on many occasions that an apportionment formula — even a formula utilizing a single factor — is "employed as a rough

approximation of a corporation's income that is reasonably related to the activities conducted within a taxing State." *Moorman Mfg. Co. v. Bair,* 437 U.S. 267, 273 (1978).

A successful domestic corporation setting up a new business in a foreign country considers whether the new business should operate as a branch or division or as a separate legal entity. This decision may depend upon the federal tax laws and the advantages and opportunities contained in its provisions. But the method of operation, as a single corporation or as separate entities, should not determine the state tax consequences.[3]

See Keesling, "A Current Look at the Combined Report and Uniformity and Allocation Practices," 42 J. of Tax. 106, 107 (February 1975). Before this Court could accept evidence based upon separate accounting systems determined and tailored to the corporation's own needs, as conclusively showing the importation of extraterritorial income from overseas to California, other offsetting factors contributing to the earning of net income must be examined in some detail.

Container therefore, should be asked, for example, what intangible values it exported to the foreign subsidiaries when it created the new businesses in foreign

[3] As succinctly stated in *Coca-Cola v. Dept. of Rev., supra* 271 Or. at 528:

"The question is fundamentally one of whether a business should stand in a better position for purposes of determining income merely because it chooses to use a multiple corporation organizational scheme. We do not feel that it should. * * *"

countries. Were the plants and machinery and equipment utilized overseas selected, purchased, set up and put into operation independently of any supervision, advice, or credit guarantees of the parent company? Were the manufacturing processes employed developed solely and exclusively by the foreign subsidiary and its personnel, or did parent know-how contribute to the adoption of such processes? Did the experience of highly parent technicians, and the top management of Container have anything to do with the profitability expectation and realization? Did the careful selection of local personnel and local management by the parent company have anything to do with the profitability? Did the existence of a relationship between Container, the parent, and the foreign subsidiary, play a part in the business dealings between the foreign subsidiary and its creditors, customers or others?

An incongruity is created by the representation in Container's statement of the case (App. Br. 44-45) that major policy matters were the responsibility of the foreign subsidiaries but were generally subject to review by Container. If major policy matters were generally reviewed by Container, it must follow that they were the responsibility of Container.

An incongruity is created by Container's statement (App. Br. 5) that each subsidiary had total responsibility for its own performance, yet was overseen by Container's foreign operations staff. How many critic-

al and significant decisions about the proper management and profitability of any one subsidiary in any one year were made by the two full-time operations officers and the senior executive officer, comptroller and lawyer during the course of each tax year in question?

Some of these questions are answered by the evidence. Some might be answered if the case is remanded for further evidence. Some may never be answered. The use of the unitary business principle and formulary apportionment obviates the need to answer all of the questions raised above.[4]

The evidence presented by Container does not show by clear and convincing evidence that there was a distortion of apportionment result and that extraterritorial values were imported to this country. Container should not be permitted to pick out income-contributing factors favorable to itself, based on separate accounting principles. Net income does not have a single identifiable source. *Container Corp. v. Franchise Tax Bd.*, 173 Cal. Rptr. 121, 132, 117 Cal. App.3d 988 (1981). The three factors of property, payroll and sales must "represent" all income earning factors, including "contributions to income which result from

[4]If California had used a constitutionally acceptable single factor formula based only on sales (the method sustained by this Court in *Moorman, supra*), what significance would there be in the wage differential between the foreign subsidiaries and the United States, or as a matter of fact, any wage differential within this country?

the functional integration and centralization which exist in a unitary operation." *Id.*, 132.

B. California's apportionment of income on a worldwide, combined basis does not result in taxation of income also taxed by foreign countries. There is no violation of the Commerce Clause.

Container's argument, that worldwide apportionment results in taxation of income also taxed by foreign countries, is completely dependent upon the use of separate accounting systems adopted by the federal government and separate accounting systems utilized by foreign countries in which Container's subsidiaries operate. Container's brief leaves the impression that something more than the income attributable to Container's activities in California is being determined. In order to disprove the correctness of California's apportionment formula method, the Court is asked to assume that separate accounting and the figures presented in the record by Container as to amounts of income attributable to various countries and to this country are above question and correct.

In *Exxon Corp. v. Wisconsin Dept. of Rev.*, 447 U.S. 207 (1980), Exxon's separate accounting showed no profit from Exxon's Wisconsin marketing operation. Oregon has had the same experience. In *Humble Oil & Refining Co. v. Dept. of Rev.*, 4 O.T.R. 284 (1970) the separate books of account maintained by Humble for the Oregon operations showed a net operating loss.

Application of formulary apportionment on the unitary basis showed a profit in both *Exxon* and *Humble*.

Separate accounting does not fairly determine the amount of income attributable to activities in a taxing state. Separate accounting is more likely to result in misattribution than formulary apportionment. On page 17 of Container's brief, separate accounting attributes $1,286,000 of income to Panama, even though the company had no property, payroll or sales in that country. There is no reason to believe that the United States Treasury was not shorted the taxation of $2,407,000 in 1963, $3,996,000 in 1964 and $5,466,000 in 1965 (App. Br. 16) because Container used separate accounting in reporting to the Internal Revenue Service. Container claims an average pretax income throughout the world for the tax years in question of $41,710,000 (App. Br. 17). For 1963, the increase in income attributable to California under its worldwide combination method was 6/10 of one percent of the worldwide income; for 1964 was one percent of worldwide income and for 1965 was 1.38 percent. This is hardly a staggering change.

The United States itself does not accept separate accounting for tax purposes at face value. Section 482 of the Internal Revenue Code provides for adjustments to prevent improper shifting of income by multinational corporations. In 1962 the United States House

of Representatives passed a version of the Revenue Act of 1962 that contained specific authorization to use a unitary method and apportionment with respect to foreign affiliates.[5] The Conference Committee determined that there was sufficient authority under I.R.C. § 482, which includes the words "apportion" or "allocate",[6] to accomplish the same result by regulation.[7]

The ineffectiveness of § 482 methods has been recognized. See "Multinational Corporations and Income Allocation under § 482 of the Internal Revenue Code", 89 Harv. L. Rev. 1202 (April 1976). This article concludes, at page 1238:

> "The use of the arm's length standard of the current section 482 regulations has been accompanied by serious problems most clearly evidenced by the surprisingly frequent reliance of revenue agents and courts on ad hoc fourth method approaches, based not on the theory of the regulation, but on the unitary entity theory. While the unitary entity theory itself is not free from difficulty, it has sufficient theoretical appeal that it deserves serious consideration as a formalized alternative to

[5] H.R. 10650, 87th Cong., 2d Sess. § 6 (1962).

[6] "In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or nor affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses." (§ 482, IRC).

[7] H.R. Rep. No. 2508, 87th Cong., 2d Sess. 18 (1962). A new regulation was promulgated which expanded upon the arm's length standard. See discussion in 89 Harv. L. Rev. 1202, 1212, cited in text, *infra*.

> current practice. At least in a short run, such consideration may take the form of its adoption as an optional safe-haven rule."

See, also, "Development in Intercompany Pricing under § 482", Seventh Annual Institute on International Taxation 103 (July 16, 1976); and G. J. Harley, *International Division of the Income Tax Base of Multinational Enterprise* (June 1980) (a treatise submitted for the degree of Doctor of the Science of Law at the University of Michigan Law School and published by the Multistate Tax Commission, Boulder, Colorado).[8]

The Comptroller General's "Report to the Chairman," House Committee on Ways and Means of the United States, entitled "IRS Could Better Protect U.S. Tax Interests in Determining the Income of Multinational Corporations", constitutes an indictment of the § 482 separate accounting method utilized by the Internal Revenue Service. This study, as well as the Harvard Law Review article and the Harley treatise referred to above, demonstrate that Container cannot reasonably represent to this Court that the arm's length method of reporting income results in an accurate determination for either the United States or any

[8]Mr. Harley's thesis is that the unitary method is theoretically superior to arm's length transactional analysis and is suitable for international adoption by the world's trading nations, acting in concert through a common, centralized, international administrative agency. Such adoption would simplify the Internal Revenue Code and its regulations, eliminate most of the present double taxation issues between nations, simplify tax treaty structures and encourage developing countries to join an international tax treaty structure.

of the foreign countries. There is no way for this Court to determine whether the figures presented by Container accurately attribute its domestic and foreign income to the United States and to other nations. Nor is there any way of determining whether the amount apportioned to California under the unitary theory, together with other amounts reported to the other several states, overstate or understate its domestic income. Conceivably, the total amount reported to the 50 states by Container does not constitute full accountability of its domestic income even under its reporting methods. In other words, if Container alleges that $28,121,000 is taxable as United States income, how do taxing officials and this Court know that this has been reported to the several states and that California has more than its proper share?

Any possibility of double taxation is alleviated not only by I.R.C. § 482, to the extent it effectively reallocates income, but by other provisions of the Internal Revenue Code, such as "Subpart F" (I.R.C. §§951 to 964) and the foreign tax credit (I.R.C. §§ 901-907). The foreign tax credit equalizes the tax burden between domestic corporations and corporations operating both domestically and overseas. The United States does not control the tax policies of the foreign country. Both countries have jurisdiction to tax the income. Therefore, in the absence of some accommodation by the foreign country, the United States, by unilaterally

permitting a foreign tax credit on foreign source income against the amount of the United States tax guarantees parity of treatment.

In summary, this Court should not conclude that the evidence and assertions of Container clearly and convincingly show that (1) Container and its subsidiaries have fully accounted for all of their taxable income to all foreign countries and to this country; (2) the distribution by separate accounting formula is proper as between the United States and foreign countries; and (3) the amount attributable to the corporation's activities in California through formulary apportionment, which is in excess of the amount attributable through separate accounting, is double taxation. It may not be reported anywhere. It may be income that should be reported to California because the separate accounting systems, as illustrated by the *Exxon* and *Humble* cases, *supra,* attribute income the way the corporation wants. Separate acco[illegible]g, in essence, is a corporate determination of where it thinks the profits should lie and nothing else.

C. California's use of unitary worldwide combined reporting does not prevent the federal government from speaking with one voice in regard to foreign policy, thereby violating the Commerce Clause.

Container's argument is based upon the erroneous assumption that the separate accounting method cor-

rectly attributes income to the various foreign countries and to the United States in such a way that any different system constitutes a system of double taxation. Container basically relies upon *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434 (1979). The decision in that case hinged on the fact that "all appellants' containers are subject to property tax in Japan and, in fact, are taxed there" (*Id.* at 452). A similar fact situation is an absolute prerequisite to any parallel holding in the income tax field. The Court cannot find a violation of the Commerce Clause unless Container has made a satisfactory showing that Container and its subsidiaries have fully accounted for all their taxable income, both domestically and in all foreign countries in which they do business, and that no part of the net income attributed to foreign subsidiaries in fact constituted the domestic net income of Container Corporation. In *Japan Line,* there was no question that the instrumentality in foreign commerce was fully taxed by Japan. It was so stipulated. In the instant case, the state is dealing with a domestic corporation which has attempted to disassociate its foreign activities by the device of foreign subsidiaries. California is attempting to determine the portion of the net income of Container Corporation that is attributable to Container's activities within the state. The attribution of net income under separate accounting can shift back and forth as various methods are

used under I.R.C. § 482 to reallocate income and expense items between related corporations.

The concept of what is "net taxable income" is abstract in nature. The final sale of the product is the ultimate realization of net taxable income. Until that time it is impossible to determine whether income is earned. For example, income taxation of a vertically integrated metals operation involves the question whether the income is "earned" by the mining operation, the smelting operation, the refining operation, the creation of the finished product (such as a pot or pan) or the efforts of the sales organization, to name only a few factors contributing to the earning of that net income. The question is different from an issue of the physical location of a container making its way from its home port in Japan to various ports around the United States and the world.

Container has not alleged, nor could it assert, that there is some internationally accepted administration of the arm's length standard. There is no international body to enforce the uniform arm's length standard among all nations and their political subdivisions, notwithstanding the existence of numerous treaties. The situation in this case would be analogous to the posture of *Japan Line* only if an international standard of separate accounting were a part of the law of every nation and the standard were uniformly administered by an international staff making adjust-

ments on behalf of nations competing for the same taxable net income, subject to the jurisdiction of an international tribunal recognized by all nations. In *Japan Line,* this Court could be certain that the container was fully taxed by Japan. In this case, there can be no certainty, under the separate and independently administered income tax systems of the many nations and their political subdivisions, that all income is reported, that the same standards of determining net income are followed, or, in short, that there is any double taxation.

This Court determined in the *Japan Line* case that when a state seeks to tax the instrumentalities of foreign commerce, two additional considerations come into play: First, the enhanced possibility of multiple taxation; and, second, that a state tax on the instrumentalities of foreign commerce may impair federal uniformity in an area where federal uniformity is essential. The tax that California seeks to impose is "levied only on that portion of the taxpayer's net income which arises from its activities within the taxing state." *Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450, 464 (1959).

To repeat, income does not have a single identifiable source. The question is the same as considered by this Court in *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113 (1920), cited with approval in *Northwestern States Portland Cement Co. v. Minneso-*

ta, supra. In the *Underwood* case the Court described the dilemma facing the state:

> "* * * The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with the sale in other states. In this it was typical of a large part of the manufacturing business conducted in the State. The legislature in attempting to put upon this business its fair share of the burden of taxation was faced with the *impossibility of allocating specifically* the profits earned by the processes conducted within its borders. It therefore adopted a method of apportionment *which, for all that appears in this record, reached and was meant to reach, only the profits earned within the state."* 254 U.S. 120-121. (Emphasis added)

This dilemma is compounded by the fact that Container operates through foreign subsidiaries. California or any other state using formulary apportionment is not "sourcing" to the state income earned in a foreign jurisdiction by a foreign subsidiary.

The first test of *Japan Line* is whether there is a substantial risk of multiple taxation. Because Container cannot show that separate accounting accurately accounts for all of its taxable income and may result in underreporting, the first test of *Japan Line* cannot be met.

The second test of impairment of federal uniformity is not implicated here. In the *Japan Line* case, California and other states had imposed property taxes on Japanese-owned containers as they moved

through the states in international commerce. The national policy, expressed in a Custom Convention on Containers, was to remove barriers to the use of containers in international traffic. The Court found that the state taxation of the Japanese containers constituted "an asymmetry in international maritime taxation operating to Japan's disadvantage." 441 U.S. at 453.

No such asymmetry can be found here. Congress has not acted to preclude the states from employing an *accounting method* to determine the amount of net income attributable to activities within a particular state. The use of an accounting method in a situation where net income cannot be sourced, as containers can be, creates no impediment or interference with the United States acting as it has, in adopting separate accounting for federal purposes in agreement with the adoption by foreign countries of separate accounting. Indeed, Congress rejected the only attempt made to date to include a specific prohibition in a treaty against the states' use of combined reporting. That was the rejection of Art. 9(4) by Congress of that provision in the United States-United Kingdom Treaty, in 1977.[8]

Notwithstanding Container's assertions that this Court's decision in *Bass, Ratcliff & Gretton Ltd. v.*

[8]Convention between the Government of the United States of America and the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation. Signed at London December 3, 1975; entered into force April 25, 1980.

State Tax Comm., 266 U.S. 271 (1924) (App. Br. fn. 2) is out of date, that case still represents this Court's recognition (as in *Wisconsin v. J. C. Penney,* 311 U.S. 435 (1940)), and *Northwestern States Portland Cement Co. v. Minnesota, supra,* that the nature of the problem of determining net income attributable to sources within a state does not impede or touch upon interstate or international commerce. An accounting method does not increase or decrease the flow of international trade. It neither affects the enforceability of tax treaties between the United States and other nations, nor violates any prohibition contained in any treaty or law enacted by the United States Congress. It cannot be shown that the income "attributed" to California is anything but part of the domestic income reported by Container to the United States Treasury, and certainly it cannot be shown that the income constitutes a part of any foreign source income.

Because *Mobil Oil Corp. v. Commissioner of Taxes of Vermont,* 445 U.S. 425 (1980) did not answer serious questions about the taxability of dividends by various states, the true question in this case might be whether the method used by California and 12 other states (App. Br. 34) is in conflict with other methods utilized by other states, in attributing Container's domestic income to the states in which it does business in this country. Domestic taxation may be the only real issue here. Container has not shown that the income attrib-

uted by California to Container's activities in California has a foreign source. There is no actual multiple taxation, and problems of multiple taxation at the international level are not germane in this case. The concurrent federal and state taxation of income is a well-established norm. If the United States Government is fearful of California and other states' attempts to obtain information for purposes of applying the unitary business principle and formulary apportionment, it may speak with one voice through Congress. The employment of an accounting method and the request for information to effectuate that method is not frustration of international tax policy nor prohibition of the United States' enforcement of that policy at the international level.

II

THE *ASARCO* AND *WOOLWORTH* DECISIONS INDICATE UNREALISTIC AND UNREASONABLE DUE PROCESS STANDARDS FOR THE UTILIZATION BY THE STATES OF THE UNITARY BUSINESS PRINCIPLE IN COMBINING AND APPORTIONING OF THE NET INCOME OF AFFILIATED CORPORATIONS.

Even if this Court should reverse *ASARCO* and *Woolworth* on rehearing with respect to the due process determinations on the inclusion of dividends and other intangible income in the apportionable income tax base, there remains for the states the barriers of the Court's language with respect to the unitary business principle as applied to affiliated corporations.

The applications of these decisions to the outcome of this case are not clear.

In dealing with the problem of attributing net income to the activities of a multinational corporation affiliated either with domestic or foreign corporations or both, state administrators are in a different position than the federal government. Oregon and other states may not operate at a deficit. States are faced with the necessity of treating taxpayers uniformly, whether it be due to application of the Fourteenth Amendment to the United States Constitution or state constitutional provisions such as Art. I, § 32 and Art. IX, § 1 of the Oregon Constitution. The federal tax system is based upon the residency theory of taxation. A state may not tax a corporation upon all of its net income, as it may tax individuals. In *Underwood Typewriter v. Chamberlain, supra,* this Court recognized that the states are "faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders," and that the method of apportionment is meant to reach "only the profits earned within the state." 254 U.S. at 121. This is the problem California faced in attempting to determine the taxable income of Container.

The inadequacies of I.R.C. § 482 adjustments based upon a "true" arm's length pricing system are notorious. The United States Congress Committee on Ways and Means has recognized that § 482 type adjustments

will not work for the states and that the states must utilize formulary apportionment. Section 28 of "Recommendations of the Task Force on Foreign Source Income," Committee on Ways and Means, U.S. House of Representatives, March 8, 1977, states in part that:

> "* * * There is no significant disagreement that States must use some type of apportionment formula (as distinguished from making an allocation of income and deductions by separate accounting), since there would be no practical way of determining what income of a company is earned within a State as opposed to being earned within other States."

Taxation is a practical matter. If the Due Process Clause, as interpreted by this Court, prohibits utilization of the unitary business principle and formulary apportionment, non-uniformity of taxation must follow. Consequently, a substantial share of the tax burden must be shifted from the multistate and multinational corporations to domestic corporations and individuals within the taxing state. The due process requirements announced in the *ASARCO* and *Woolworth* cases may constitute standards which the states cannot meet with any reasonable personal resources and of auditing procedures.

Two areas are of particular concern: (1) What does this Court mean by "potential to operate a company as a part of a unitary business" and "actual control"; and

(2) what must be the relationship of the subsidiary's activities to the activities in the taxing state?

1. *"Potential" as contrasted with "actual" control.* The court in *F. W. Woolworth Co. v. Taxation and Revenue Dept., supra,* (slip op. at 7) states:

> Our decision in ASARCO makes clear, however, that the *potential* to operate a company as part of a unitary business is not dispositive when, looking at 'the underlying economic realities of a unitary business,' the dividend income from the subsidiaries *in fact* is derive[d] from 'unrelated business activities' which constitutes a 'discrete business enterprise.' ". (Referring to ASARCO and its subsidiary M.I.M. in which ASARCO owned 52.7 percent of the stock.)

This Court then turns to the discussion of functional integration, centralization of management, and economies of scale. The Court refers to *Butler Bros. v. McColgan, supra,* 315 U.S. at 508-509. *Butler Bros.,* is a decision involving only a single domestic corporation. The *Woolworth* decision also relies heavily upon this Court's decision in *Exxon, supra,* another case involving only a single domestic corporation.

The "underlying economic realities" in the case of a domestic parent and foreign subsidiaries are entirely different. It is possible that, in a worldwide operation where a product may not flow from overseas to this country, the market place in a particular country may be serviced by local production or by an exchange agreement such as was found in *Exxon.* In the instant

case, practical economic realities would dictate that purchase of wholesale goods for resale to final customers would take place at the market place closest to the retail operation, due to the economies of transportation and the tastes and habits of the local consumers. These factors do not foreclose characterization of the operation as unitary. This question could be supervised by one or two officers of the parent company, and adequate controls could be maintained by the usual and ordinary lines of communication and financial reporting made by a subsidiary to its parent.

There might be good reasons by Woolworth, for example, would not engage in a centralized purchasing, warehousing and merchandise operation encompassing such far flung operations as Germany and Mexico. However, economies of scale with respect to the market place in a particular country could still obtain, and final decision making and approval could come from the parent's place of business. Such appears to be the case with Container. This is the economic reality.

With respect to the utilization of separate corporations rather than divisions in one company, common sense and economic realities dictate that, especially with a foreign country, foreign personnel be utilized as much as possible. As in the case of Container, it made political sense to have local operations conducted by efficient and well trained local personnel. An efficient

parent could still maintain control of its subsidiaries. Regulation of its own day-to-day activities by a subsidiary is not the exception; it is the rule. Where distance, language differences and diverse markets intervene, there are going to be different methods of operation and management. But this does not mean that the parent corporation is not exercising control and that it is not a unitary operation.

The question is how a state may apply the test in *Exxon,* 447 U.S. at 207, on a worldwide basis where a state must prove:

> "* * * long-range planning for the company, maximization of overall company operations, development of financial policy and procedures, financing of corporate activities, maintenance of the accounting system, legal advice, public relations, labor relations, purchase and sales of raw * * * materials and coordination between * * * operating functions. * * *"

To do this on an year-to-year basis, with regard to the parent and each of its subsidiaries, the state will have to have its auditors examine the affairs of each corporation on a day-to-day basis, read corporate and committee minutes of the corporation, inquire about telephone calls, and otherwise gather the intimate indicators of control. It is no secret that control may be effectively maintained by several persons through selection of like-minded subordinates, directed through telephone communications and internal memoranda. American business has numerous

examples of "one man" operations. Certainly a small staff in the office of Container could control the activities of foreign subsidiaries for all practical purposes.

2. *Relationship of the activities of the foreign corporation to activities within the taxing state.*

This Court should explain that its language in the *ASARCO* and *Woolworth* cases requires only a "rational relationship", in the sense that the activities in the taxing state and the activities of the subsidiary are links in a common chain even though the chain has several links. In a unitary business, such as a vertically integrated operation, mining in one state is, in turn, connected to a smelting operation in another state, a refining operation in a third state, a manufacturing operation in a fourth state, and a sales organization in a fifth state from which the final product is marketed in 50 states and in several foreign countries. This Court's statement in *Mobil,* 445 U.S. at 441-442, about business activities of a foreign subsidiary having "nothing to do with the activities of the * * * taxing state", cannot mean that the states have a due process burden of showing that the mining activities on a day-to-day basis are connected to the sales operation, other than as a part of the "chain of events" running through the vertically integrated operation.

In considering this case, the Court should distinguish clearly *ASARCO* and *Woolworth* and set its due

process standard no higher than necessary to recognize the true, economical realities of international corporate operations. The Court should consider that intangible methods of control may defy discovery unless a state audit department resorts to unreasonable audit time and unrealistic staff requirements, which have the potential to harass the taxpayer.

III

THE FACTS IN THIS CASE SUPPORT THE CONCLUSION THAT CONTAINER IS UNITARY WITH ITS FOREIGN SUBSIDIARIES.

The brief of Appellee Franchise Tax Board adequately presents the factual situation presented here. Amicus believes that the lower court's opinion correctly analyzed the factual situation. Barring establishment of a prohibitive standard based upon language in *ASARCO* and *Woolworth,* this Court should find that the state sufficiently demonstrated that Container conducted a unitary operation. The judgment of the lower court should be affirmed.

Respectfully submitted,

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